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No. 22

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. A. SPROUSE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 19–33) is reported in 42 B. T. A. 484. The opinion of the Circuit Court of Appeals (R. 50–54) is reported in 122 F. (2d) 973.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on October 22, 1941. (R. 55.) The petition for a writ of certiorari was filed on January 21, 1942, it was denied on March 2, 1942, and

a petition for rehearing was denied on March 30, 1942. On May 11, 1942, the order denying certiorari was vacated and the petition was granted. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the owner of voting common stock of a corporation realized taxable income upon the receipt of a stock dividend based upon corporate earnings and paid in nonvoting common stock of the corporation.

CONSTITUTIONAL PROVISIONS, STATUTE, AND REGULATIONS INVOLVED

The constitutional provisions, statute and regulations involved are set forth in the Appendix to the brief for the Government in *Strassburger* v. *Helvering*, No. 66, October Term, 1942.

STATEMENT

The facts, as stipulated (R. 12–19) and as found by the Board (R. 21–25), may be summarized as follows:

The respondent, R. A. Sprouse, was the owner of voting common stock in Sprouse-Reitz Company, Inc., an Oregon corporation, which, on February 13, 1936, paid a 10 per cent stock dividend in new shares of its nonvoting common stock. (R. 12, 14, 21, 22.) The corporation had

outstanding only two classes of stock, voting and nonvoting common stock having par values in the respective aggregate amounts of $397,471.25 and $819,333.06.[1] (R. 13, 21.) The stock dividend consisted of $121,680.43 par value nonvoting common stock which was distributed to the holders of both the voting and nonvoting common in proportion to their respective stockholdings.[2] (R. 14, 15, 22, 23.) The fair market value of the nonvoting common stock at the time of distribution was equal to its par value. (R. 15, 23.)

The earnings and profits of the corporation available for distribution at the time of the dividend were not less than $200,000.[3] (R. 15.)

The respondent received 200 shares of the nonvoting common stock having a fair market value

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[1] The corporation had authorized capital stock of $2,000,000, consisting of 6,000 shares of voting common, 12,000 shares of nonvoting common, and 2,000 shares of nonvoting preferred stock, the shares of each class having a par value of $100 each. (R. 13, 21.)

[2] Although Finding 5 (R. 23) states that the distribution was "in proportion" to the respective stockholdings of both classes, Finding 3 (R. 22) gives specific figures that are slightly at variance with that conclusion. Thus, pursuant to Finding 3, the voting common received a $40,333.34 dividend in nonvoting common and the nonvoting common received an $81,347.09 dividend in nonvoting common. However, the Government concedes, for the purposes of this case, that the statement in Finding 5 is correct.

[3] On the same day that it paid the $121,680.43 stock dividend, February 13, 1936, the corporation also paid a 6% cash dividend in the aggregate amount of $73,008.26, which was distributed among the holders of both classes of stock. (R. 14.)

of $20,000 as his share of the distribution. (R. 15, 17, 23, 24.) Prior to the dividend, he did not own any nonvoting common. (R. 17, 24.) In his 1936 income tax returns, he did not report any income on account of that dividend. The Commissioner determined a deficiency by including the value of the stock dividend as income, and the Board of Tax Appeals sustained the determination.[1] (R. 19–33.) The Circuit Court of Appeals reversed, holding that the stock dividend could not constitutionally be subjected to tax if it were distributed to holders of both classes of outstanding stock in proportion to their stockholdings. (R. 50–54.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividend could not constitutionally be subjected to tax.

2. In holding that the nonvoting common stock which taxpayer received as a dividend upon his voting common stock was not income to the taxpayer.

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[1] The corporation also paid a dividend in nonvoting preferred stock on its voting and on its nonvoting common stock in December, 1936. (R. 14–15, 22.) In this distribution taxpayer received preferred stock of a par and a market value of $22,300. (R. 15, 17, 23, 24.) The Commissioner treated this stock dividend as taxable, and the Board also upheld this part of the Commissioner's determination. Upon appeal to the court below the taxpayer did not challenge this part of the Board's decision.

3. In failing to hold that taxpayer realized income in the amount of the fair market value of the shares of nonvoting common stock which he received as a stock dividend upon his shares of voting common stock.

4. In reversing the decision of the Board of Tax Appeals.

ARGUMENT

This case is a companion case to *Strassburger* v. *Helvering*, No. 66, and we respectfully refer the Court to our brief in that case for a full discussion of the issues involved. We contend that the stock dividend here involved was income to the respondent within the meaning of the Sixteenth Amendment, and taxable to him under the applicable provisions of the Revenue Act of 1936. To the extent that *Eisner* v. *Macomber*, 252 U. S. 189, holds to the contrary, we submit that it was erroneously decided and should now be overruled.

If, however, this Court should not overrule *Eisner* v. *Macomber* then we submit that the stock dividend *sub judice* was income to the respondent under *Koshland* v. *Helvering*, 298 U. S. 441, and *Helvering* v. *Gowran*, 302 U. S. 238. Cf. *Chapman* v. *United States*, 63 C. Cls. 106; certiorari denied, 275 U. S. 524, decided prior to the *Koshland* decision. Prior to the receipt of the stock dividend the respondent owned only voting stock, but the distribution of the stock dividend constituted a readjustment of the corporate structure

such that he could sell his nonvoting stock and still retain the same control over the enterprise. This new stock represented corporate earnings convertible into cash by sale without diminishing the respondent's basic interest any more than would have been the situation in the *Koshland* case had the stockholder there sold the stock dividend. Since the new stock represented an interest different in kind from that theretofore held by the respondent, it is immaterial that the dividend might not have affected his *proportionate* interest in the corporate assets. A cash dividend does not alter the stockholder's proportionate interest, and yet it is indisputably taxable as income; the result should not be different here.

CONCLUSION

The decision below is erroneous and should be reversed.

Respectfully submitted,

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